

THE TAXATION OF TRUSTS IN SADC MEMBER STATES

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1 Introduction

It is generally acknowledged that the trust¹ originated in the English law.² Yet, trusts are used (or at least recognised) in most jurisdictions worldwide.³ In fact, many Southern African Development Community (“SADC”) member states⁴ use trusts. Evidence of the use of trusts was found in Botswana, Lesotho, Malawi, Mauritius, Namibia, Seychelles, Swaziland, Tanzania, Zambia and Zimbabwe. Perhaps this is not surprising, taking into account the influence of the English law on many of its former colonies.⁵ Despite a concerted effort, no indication could be found that trusts are used in Angola, the Democratic Republic of the Congo, Madagascar or Mozambique. Although it may be possible that relevant information was missed due to language barriers,⁶ a more likely explanation is that trusts are unknown in these states, because the law in these states is based primarily on civilian principles, or were significantly influenced by civilian principles. Consequently, this article is limited to a

¹ For purposes of this article, the rather broad and general definition of a trust, as found in article 2 of Hague Convention on the Law Applicable to Trusts and on their Recognition (adopted on 1 July 1985, entered into force 1 January 1992), will be used. This definition reads as follows:

“For the purposes of this Convention, the term ‘trust’ refers to the legal relationships created – *inter vivos* or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.

A trust has the following characteristics –

- a) the assets constitute a separate fund and are not part of the trustee’s own estate;
- b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;
- c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.

The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.”

² E Cameron, M de Waal, B Wunsh, P Solomon & E Kahn *Honorés South African Law of Trusts* (2002) 2.

³ 2.

⁴ SADC member states comprise of Angola, Botswana, Democratic Republic of the Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

⁵ For example, during British rule in the former Cape Colony in South Africa, settlors and officials introduced the English trust. From there it was exported, albeit in modified form, *inter alia*, to Botswana (see the text to part 3 1 below) and Namibia (see the text to part 3 5 below). M de Waal “The Core Elements of the Trust: Aspects of the English, Scottish and South African Trusts Compared” (2000) 117 *SALJ* 548 548; Cameron et al *Honoré’s South African Law of Trusts* 2

⁶ The author does not read or speak French or Portuguese. Virtually all information regarding business forms and taxation in these states are only available in these languages. It was therefore difficult for the author to obtain information. Translating vast amounts of legislation and other documents was not practically feasible.

study of SADC member states that were former British colonies and/or states in which Britain or British law had a significant influence. Therefore, Angola, the Democratic Republic of the Congo, Madagascar and Mozambique will not be addressed in this article.

Bearing in mind trusts' flexibility and the wide variety of purposes for which trusts may be used, trusts are very popular vehicles in some SADC member states. For example, in South Africa in 2015 there were 33 465 active trusts registered with the South African Revenue Service ("SARS").⁷ Trusts have proved to be less popular in other states, though. For example, in Lesotho there are only 15 trusts registered with the Lesotho Revenue Authority⁸ and in Mauritius in 2010 only 216 tax resident trusts were registered with the Mauritian Revenue Authority, while 28 trusts were licenced as Global Business Licence Companies.⁹ No statistics regarding the use of trusts in the other SADC member states could be obtained from publicly available sources.

Since trusts are used in the majority of the SADC member states, a closer inspection of the way in which they are taxed for income tax purposes¹⁰ and a comparison of these methods seems warranted. However, there are further reasons why such an investigation is necessary at this time.

First, globalisation has led not only to the escalation of cross-border transactions, but also to an increase in the mobility of individuals, resulting in the internationalisation of their investments. Trusts are therefore increasingly being used in international transactions.¹¹ The now infamous Panama Papers¹² serves to illustrate this point. According to the documentation making up the Panama Papers, entities, including trusts, were often used as special purpose vehicles, in which large sums of capital were placed. Sometimes, these trusts were used to protect assets from questionable origin, by ensuring that they were "invisible to, and unreachable by, the owners' claimants".¹³ Many prominent residents from SADC member states have been linked to the Panama Papers. For example, a family member of a former South African president¹⁴ was mentioned in these documents. So too was an alleged link between the Italian mafia and a family member of a former Namibian president.¹⁵ More pertinent to this article is the example of a Malawian trust, which, according to reports

⁷ The Davis Tax Committee *Second and Final Report on Estate Duty* (2016) 25. Of course, there may be active trusts that are not registered with SARS.

⁸ OECD *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Lesotho 2015: Phase 1: Legal and Regulatory Framework* (2015) para 83.

⁹ OECD *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Mauritius 2013: Combined: Phase 1 + Phase 2, incorporating Phase 2 ratings* (2013) para 102.

¹⁰ All other forms of taxation, including capital gains tax, fall outside the scope of this article.

¹¹ M Cadesky & R Pease "Introduction and Overview of Issues" in M Cadesky & R Pease (eds) *Trusts and international tax treaties* (2006) 11; RJ Danon *Switzerland's direct and international taxation of private express trusts: with particular references to US, Canadian and New Zealand trust taxation* (2004) 1.

¹² The Panama Papers represent a set of confidential client information and internal papers of the Panamanian law firm, Mossack Fonseca (R Weisbord "A Catharsis for U.S. Trust Law: American Reflections on the Panama Papers" (2016) 116 *Colum L Rev* 93 95).

¹³ 94.

¹⁴ J Wicks "The Panama Papers and the Zuma link" (04-04-2016) *News24* <<http://www.news24.com/SouthAfrica/News/the-panama-papers-and-the-zuma-link-20160404>> (accessed 20-11-2017).

¹⁵ T Mongudhi & N Kahiurika "Nujoma and the 'Panama Papers'" (07-04-2016) *The Namibian* <<https://www.namibian.com.na/149376/archive-read/Nujoma-link-in-Panama-Papers>> (accessed 20-11-2017).

on the Panama Papers, registered a subsidiary in an offshore tax haven.¹⁶ It must be pointed out, however, that not all trusts mentioned in the Panama Papers were involved in untoward transactions and this article will not deal with tax evasion, money laundering or corruption. These examples mentioned in the Panama Papers simply illustrate how frequently trusts are used in international transactions.

A second reason why it is pertinent to investigate the taxation of trusts in the SADC member states is that the OECD's project on Base Erosion and Profit Shifting ("BEPS") has also placed the focus on the use of trusts in international transactions. For example, trusts feature prominently in its report on hybrid mismatch arrangements, highlighting that they are often used in international structures.¹⁷ Furthermore, the OECD's recommendations have resulted in the amendment of article 13(4) of the OECD Model Tax Convention on Income and on Capital (the "OECD MTC"), dealing with capital gains on the alienation of shares which derive more than 50% of their value from immovable property, to also refer to the alienation of an interest in a trust. Moreover, the Commentary to the OECD MTC was amended to refer to the treatment of trusts, reflecting their frequent use in the international sphere. Given this renewed interest in trusts, it is pertinent to consider the way in which trusts are taxed in different states.

Third, even though trusts are not used very frequently in some SADC member states, residents of these states may form trusts in other states or be beneficiaries of trusts resident in other parts of the world. SADC member states would therefore have to be prepared to deal with cross-border transactions between residents and non-resident trusts, as well as distributions by non-resident trusts and cannot shy away from these issues. Due to these situations occurring frequently, some states in which trusts cannot be formed (typically states with a civil law tradition) have in the last couple of years introduced legislation dealing with the taxation of the transactions between trusts and the residents of these states. For example, in the Netherlands, legislation on the taxation of trusts was introduced with effect from 2010.¹⁸ Similarly, Belgium introduced a so-called "Cayman tax" in 2015 to regulate the taxation of trusts.¹⁹ It is submitted that the introduction of legislation in these states that do not traditionally use trusts, show the prevalence of cross-border transactions involving trusts, as well as the need to regulate the taxation of trusts in these situations.

Fourth, the SADC member states have agreed to co-operate in the areas of, *inter alia*, trade, industry, finance, investment and mining. They have also undertaken to coordinate, rationalise and harmonise their overall macro-

¹⁶ C Mtika "Panama Papers: Press Trust amount 46 businesses in off-shore tax haven" (17-05-2017) *Malawi24* <<https://malawi24.com/2016/05/17/panama-papers-press-trust-among-46-malawi-businesses-off-shore-tax-haven/>> (accessed 16-10-2017).

¹⁷ OECD *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report* (2015).

¹⁸ S 2.14a of the Wet inkomstenbelasting 2001.

¹⁹ S Geluyckens "Belgium – Individual Taxation" (undated) *IBFD Tax Research Platform* para 1.5.5.1 <https://online-ibfd-org.ez.sun.ac.za/kbase/#topic=doc&url=/collections/ita/html/ita_be_chaphead.html&q=trust%20trusts&WT.z_nav=outline&hash=ita_be_auth> (accessed on 31-10-2017).

economic policies and strategies, programmes and projects.²⁰ In this regard, the member states entered into a memorandum of understanding in which they recognise the need to co-operate in taxation matters and to harmonise the tax regimes of the Member States and in which they have agreed to certain measures.²¹ This article will not focus on harmonisation and no opinion is expressed as to whether this should indeed be done or whether there is a need for harmonisation. However, if, in future, further harmonisation is to take place, states will have to be aware of each other's positions, so that negotiations can take place from these positions. Consequently, the way that each SADC member state taxes trusts will have to be established and the differences and similarities identified as part of the co-operation and harmonisation project.

In this article only the general regime for the taxation of trusts in each state was examined. Trusts that are subject to special regimes, such as collective investment vehicles (also known as unit trusts) or charitable trusts were not included. Generally, anti-avoidance measures, such as the taxation of trust income in the hands of other parties, were not addressed.

2 Policy considerations and systems for the taxation of trusts

According to Wheeler, many common-law states follow the same broad policy aim in the taxation of trusts, namely that income passing through the trust is taxed only once. She adds, however, that the mechanisms used to achieve this aim differ significantly.²² One of the questions that this article will aim to answer is whether the SADC member states discussed here also have the same broad policy objective of taxing the income passing through a trust only once.

Academics have classified the systems used by other states to tax trusts in more than one way. However, none of these studies referred to the systems used by the SADC member states. Therefore, a further question that this article will address is to test whether the tax systems used by the applicable SADC member states can be classified in the same way as these other (typically common law) systems. Hence, the various classifications will be discussed.

One classification focuses on the mechanism used. Another focuses on the person that is to be taxed, while the last classification distinguishes between an entity system and a flow-through system.

Under the first classification, three systems are identified, namely (a) the initial choice system; (b) the credit system; and (c) the deduction system. In the initial choice system, a choice, whether to tax the beneficiary or the trust, is made as trust income arises. Thus, generally speaking, if a beneficiary is entitled to the trust income, or it is distributed to the beneficiary within the tax year, it is taxed in the hands of the beneficiary. If, however, no beneficiary is entitled to the income, the trust will be liable to tax on the income (a typical example being retained income). When the income is eventually distributed

²⁰ Art 21 of the Treaty of the Southern African Development Community (adopted on 17 August 1992, entered into force 5 October 1992) 32 ILM 116.

²¹ SADC *Memorandum of Understanding on Co-operation in Taxation and Related Matters* (2002).

²² J Wheeler "The Missing Keystone of Income Tax Treaties" (2011) 3 *World Tax Journal* 247 345.

to the beneficiary, no tax is imposed on either the trust or the beneficiary. Australia and New Zealand are examples of states that mainly use this system.²³

In the credit system, both the trustee and the beneficiaries are taxed: the trustee on the trust income and the beneficiaries on the distribution. However, the beneficiaries are granted a credit for the tax paid by the trustee. This is the general system followed in the United Kingdom and Ireland, although there are notable exceptions. In the deduction system both the trust and beneficiaries are again taxed, but this time, the trust is allowed a deduction for the distribution made to the beneficiary. Generally, Canada and the United States of America follow the deduction system.²⁴

A different way of classifying systems of taxing trusts would be to focus on the person being taxed. Thus, (i) some states tax trusts based on the residency of the settlor; (ii) some states tax trusts based on the residency of the trustee (or trust); and (iii) some states focus on taxing the beneficiaries.

The policy behind taxing trusts based on the residency of the settlor (item (i)) is that there is a perception that the settlor, having transferred the biggest part of the trust assets to the trust, will have substantial control over the assets and, furthermore, that the state in which the settlor resides should have the economic basis for taxing the trust, where the trust is established in a low-tax state. Under this system, either the trust income is attributed to the settlor personally, or the trustee is held liable for the tax on the trust income, based on the settlor's residence. New Zealand is identified as a state that uses this system.²⁵ The United States of America's "grantor trust" regime is also regarded as a system where taxation is based on the residence of the settlor.²⁶ The systems introduced in the Netherlands and Belgium also, generally, tax trust income in the hands of the contributor (typically the settlor²⁷). A weakness of this type of system is that it may be unfair to tax a settlor on the whole of the trust income if the settlor has only made a small contribution to the trust fund, with the greatest part of the trust funds arising from other sources.²⁸

In the case of states which tax trusts based on the residence of the trustee (or trust) (item (ii)) the focus is placed on the person(s) who is legally the owner(s) of the trust property. The United Kingdom is regarded as an example

²³ 347; J Wheeler "Taxation of Trusts in Common Law Jurisdictions" in R Danon, J Chenaux & N Tissot (eds) *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* (2010) 37; IA Koele "Trusts and the Application of the OECD Model Convention" in F Sonneveldt & HL van Mens (eds) *The Trust: Bridge or Abyss between Common and Civil Law Jurisdictions* (1992) 85-87.

²⁴ See Wheeler (2011) *World Tax Journal* 347-349; Wheeler "Taxation of Trusts in Common Law Jurisdictions" in *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* 37; Koele "Trusts and the Application of the OECD Model Convention" in *The Trust: Bridge or Abyss between Common and Civil Law Jurisdictions* 85-87.

²⁵ JW Hart "How Various Countries Approach Taxation of Trusts" in M Cadesky & R Pease (eds) *Trusts and International Tax Treaties* (2006) 55.

²⁶ 60. Hart describes a grantor trust as one in which the settlor retains certain rights, benefits and powers and where, on a federal level, the settlor is taxed as if he or she still owns the trust assets.

²⁷ X Auerbach "Taxation of Trusts in the Netherlands" in RJ Danon, N Tissot and JL Chenaux (eds) *Taxation of Trusts in Civil Law Jurisdictions 2nd Symposium of International Tax Law* (2010) 223, 251; Gelyuckens (undated) *IBFD Tax Research Platform* para 1.5.5.1.

²⁸ Hart "How Various Countries Approach Taxation of Trusts" in *Trusts and International Tax Treaties* 55.

of such a state²⁹ and Canada may be added to this list. Some states tax trusts based on the fact that the beneficiaries are resident in that state (item (iii)). Under this system beneficiaries may be taxed either when they receive the trust income, or the income may be imputed to them, regardless of whether it was distributed to them or not. Both these options have their challenges. For example, if beneficiaries are only taxed when they receive trust income, trusts that are situated in low tax jurisdictions will most probably accumulate the trust income, delaying distributions to beneficiaries.³⁰ However, this option has the advantage of relative simplicity.³¹

In the last classification, a distinction is made between taxing a trust as a separate entity and taxing the trust in a hybrid flow-through system. The hybrid flow-through system entails that the beneficiaries are taxed on the income distributed to them (or to which they are entitled) in the particular tax year, whilst the trust is taxed on all income not so distributed. Canada is an example of a state that uses such a system.³² It is submitted that the hybrid flow-through system is similar to the initial choice system and the deduction system identified in the first classification above. If the trust is taxed as a separate entity, the trust income is taxed in the hands of the trust only. Distributions to the beneficiaries will not be taken into account in determining the amount taxed in the trust's hands and no tax will be imposed when a distribution is made to a beneficiary.³³ According to Thuronyi and Easson, such a system can be unfair if the income is distributed to a beneficiary with a low tax rate.³⁴ The unfairness can be addressed by granting the beneficiary a refundable credit for the taxes paid by the trust. Such a system is broadly used in the United Kingdom.³⁵ It is submitted that the separate entity system, coupled with the credit, corresponds with the credit system described in the first classification above. Thuronyi and Easson point out that there is very little difference between the hybrid flow-through system and the separate entity system in which a refundable credit is granted.³⁶

Interestingly, academics concede that many states adopt a combination of these systems.³⁷

The questions posed above regarding the taxation of trusts in the SADC member states, will be addressed by providing an overview of the taxation of trusts and the other parties to the trust relationship, in each of the relevant

²⁹ 62.

³⁰ 65.

³¹ V Thuronyi & A Easson "Fiscal Transparency" in V Thuronyi (ed) *Tax Law Design and Drafting* (1998) 28.

³² 26-27.

³³ 26-27.

³⁴ Trusts would have to be taxed at a relatively high rate to deny individuals the opportunity to simply move income into a trust and retain it there.

³⁵ Thuronyi & Easson "Fiscal Transparency" in *Tax Law Design and Drafting* 26-27.

³⁶ 27.

³⁷ Hart mentions the example of Australia that uses all three systems (items (i) to (iii)). In the United Kingdom and Canada, certain anti-avoidance provisions also attribute the trust income to the settlor under certain circumstances, which would result in these states falling under item (i) as well. See also Cadesky & Pease "Introduction and Overview of Issues" in *Trusts and International Tax Treaties* 9; Thuronyi & Easson "Fiscal Transparency" in *Tax Law Design and Drafting* 27.

SADC member states. Thereafter, it will be established whether the relevant state's broad policy aim is to tax trust income only once. Furthermore, an attempt will be made to classify the system used by each state in accordance with the classifications discussed above. Moreover, it will be evaluated whether the applicable SADC member states have the same broad policy aim and whether it is possible to classify the systems used by these states into the present classification system. Finally, several trends in the taxation of trusts in these states will be identified. It is hoped that such an analysis will assist the SADC member states in their co-operation and integration efforts. The relevant SADC member states will be discussed in alphabetic order.

3 The taxation of trusts in the relevant SADC member states

3.1 Botswana

To appreciate the existence of trusts in Botswana, the history of the country's legal system must be considered. The British declared a protectorate over Botswana in 1885, but soon placed its administration in the hands of the Government of the Cape of Good Hope, which was then known as the Cape Colony. At the time, the Cape Colony was a British colony, but today this area forms part of South Africa. In 1891, a proclamation was published, which made the law of the Cape Colony as it changed from time to time, applicable to Botswana.³⁸ Upon independence in 1966, Botswana retained the law applicable at the time in the country.³⁹ Thus, the trust law that formed part of the law of the Cape Colony, also formed part of and still forms part of the law of Botswana. It is therefore undeniable that there are many similarities between the trusts found in South Africa and those found in Botswana.

But, how are trusts taxed in Botswana? Income tax is charged in terms of the Income Tax Act, Cap 52:01 (the "Botswana ITA"). In general, Botswana applies a source-based system.⁴⁰ However, certain amounts are deemed to have accrued from a source in Botswana. For example, any investment made outside Botswana or any business carried on outside Botswana by a resident of Botswana will be deemed to have accrued from a source within Botswana.⁴¹ For these purposes, a trust is regarded as a resident of Botswana if it is established or administered in Botswana.⁴² Consequently, it is possible for a trust established in another state to be regarded as a Botswana resident if it is administered in Botswana.

The Botswana ITA furthermore provides that tax shall be charged for each tax year on the taxable income of every person for that tax year.⁴³ The definition of a person includes a trustee.⁴⁴ The Botswana ITA also states that

³⁸ C Fombad "Botswana's Legal System and Legal Research" (2015) *GlobaLex* <<http://www.nyulawglobal.org/globalex/Botswana1.html>> (accessed on 20-05-2017).

³⁹ S 2 of the Botswana Independence Act of 1966.

⁴⁰ S 9 of the Botswana ITA.

⁴¹ S 11(1).

⁴² S 2.

⁴³ S 8(1).

⁴⁴ S 2.

an amount accrued to a trust for the benefit of another person forms part of the trust's taxable income. For these purposes, the term trust includes a will or other testamentary disposition, as well as a deed of donation, settlement or other disposition. However, the amount is charged to tax in the name of the trustee in the same sum as would have been charged if such amount had been included in the gross income of the trustee.⁴⁵ Therefore, income is taxed in the hands of the trustee, irrespective of whether or not it is distributed to a beneficiary during the particular year.⁴⁶ The tax rate will depend on whether the trustee is an individual or company.⁴⁷ If the trust distributes income to the beneficiary, the beneficiary is not liable for any further tax, since the trust has already been taxed on the income.⁴⁸ Consequently, a trust resident in Botswana that earns income in Botswana, or that holds foreign investments and earns income from them, is liable to tax on the income in Botswana. However, once that income is distributed to the beneficiaries, no income tax will be payable by them in Botswana, irrespective of where the beneficiaries are resident. Trusts that are non-resident in Botswana will only be liable for tax on income accrued from a source in Botswana.

Nevertheless, if the provisions of a trust are to the effect that the beneficiaries therein, or some of them, shall not receive any amount until the happening of an event, whether fixed or contingent, any such amount as would, but for the stipulation, have accrued to the beneficiaries shall, until the happening of that event, be deemed to have accrued to the trust. It shall therefore be included in the gross income of the trust and the taxable income ascertained therefrom shall be charged to tax in the name of the trustee.⁴⁹

Thus, it seems that Botswana subscribes to the general policy objective of taxing income passing through the trust only once. However, the Botswanan system cannot be easily classified into any of the systems based on the method used, because income is simply taxed in the hands of the trustee and the beneficiary is not liable for any further tax upon distribution. Rather, the Botswanan system is a pure entity system, without a credit granted to the beneficiary. Furthermore, it is also difficult to classify the Botswanan system based on the person being taxed, since Botswana generally uses a source-based system and not one focused on the residence of a person.⁵⁰

⁴⁵ S 19.

⁴⁶ OECD "Global Forum on Transparency and Exchange of Information for Tax Purposes - Organisation for Economic Co-operation and Development" (2016) *OECD* para 103 <<http://www.oecd.org/tax/transparency/>> (accessed 05-06-2017).

⁴⁷ OECD "Global Forum on Transparency and Exchange of Information for Tax Purposes - Organisation for Economic Co-operation and Development" (2016) *OECD* para 23.

⁴⁸ OECD "Global Forum on Transparency and Exchange of Information for Tax Purposes - Organisation for Economic Co-operation and Development" (2016) *OECD* para 103.

⁴⁹ S 14(2) of the Botswana ITA.

⁵⁰ One could argue that the Botswana system shows elements of the system based on the residence of the trustee, since it taxes income from investments made outside Botswana or any business carried on outside Botswana by a trust resident in Botswana, in the hands of the trustee of that trust.

3.2 Lesotho

Trusts are created in Lesotho under common law, as there is no legislation dealing with the creation, administration or monitoring of trusts.⁵¹ Income tax is charged in Lesotho on a residence basis in terms of the Income Tax Act 9 of 1993 (the “Lesotho ITA”).⁵² Thus, non-residents are only taxed on their Lesotho source income.⁵³ However, the Lesotho ITA does not specify when a trust will be a resident in Lesotho (Income Tax Act 9 of 1993, part II).⁵⁴ In Lesotho, income is taxed in the hands of either the trustee (and not on the trust)⁵⁵ or the beneficiary.⁵⁶ Nevertheless, the Lesotho ITA does not include a trustee or a trust in the definition of a person. Arguably, such an inclusion in the definition would be redundant, since the trust is not taxed and a trustee, typically an individual or a company, would already be a person. A similar argument may explain the absence of a provision stipulating when a trustee will be resident in Lesotho.⁵⁷

A resident beneficiary is taxed on the share of the trust income to which he or she is presently entitled. However, non-resident beneficiaries are only taxed on the Lesotho-source income of the trust to which such a beneficiary is presently entitled.⁵⁸ Income, expenses, or losses derived or incurred by a trustee retain their character as to geographic source and type of income, expense, or loss in the hands of the beneficiary, but a beneficiary is not allowed a deduction for a trust loss.⁵⁹

Although trust income or loss is calculated as if the trust were a resident individual taxpayer,⁶⁰ the trustee is liable to income tax only on the chargeable trust income that is from a Lesotho source. However, a trustee is also liable on chargeable trust income from a foreign source, but only where one of three conditions are met, namely the grantor was a resident at the time of making a transfer to the trustee, or is a resident in the year of assessment in question, or where a resident person may ultimately benefit from the income.⁶¹ Nevertheless, in order to determine the chargeable trust income for a year of assessment, the trust income is reduced by (i) the amount included in the gross income of any beneficiary; and (ii) in the case of a non-resident beneficiary, the amount of the trust income to which the beneficiary is presently entitled (in other words, the deduction is not limited to income of a Lesotho source).⁶²

⁵¹ OECD “Tax, Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Lesotho 2015 – Phase 1: Legal and Regulatory Framework” (2015) *OECD* 35 <<http://www.oecd.org/tax/global-forum-on-transparency-and-exchange-of-information-for-tax-purposes-peer-reviews-lesotho-2015-9789264237742-en.htm>> (accessed 05-06-2017).

⁵² S 17(2) of the Lesotho ITA.

⁵³ S 17(3).

⁵⁴ Part II provides when individuals, companies, partnerships and superannuation funds will be resident, but contains no provision regarding the residence of trusts.

⁵⁵ Ss 4(1) and 81(1). The definition of the term person in section 1 does not include a trust.

⁵⁶ S 82(1).

⁵⁷ However, if there is more than one trustee it may be problematic to determine where the trustees are resident. Legislation should preferably determine this.

⁵⁸ Income Tax Act 9 of 1993, S 82(2) of the Lesotho ITA.

⁵⁹ Ss 81(6) and 82(3).

⁶⁰ S 81(3).

⁶¹ S 83(1).

⁶² S 83(2).

Therefore, beneficiaries are taxed only on the income to which they are presently entitled (and in the case of non-resident beneficiaries, the income is limited to Lesotho sourced income). Although trustees are taxed on income, a deduction is available for the trustees in respect of the income on which the beneficiary is taxed. Furthermore, the income on which the trustees are taxed is limited to Lesotho source income, unless one of the three conditions is met. Thus, the foreign sourced income earned by a Lesotho trust, which has non-resident beneficiaries, remains untaxed in Lesotho. However, grantor trusts and qualified beneficiary trusts are excluded from this regime.⁶³

It is submitted that Lesotho's system makes it a very tax friendly destination for non-residents. Provided that the three conditions are not met and the requirements for grantor and qualified beneficiary trusts are avoided (which can be achieved easily enough), it is possible for a non-resident to set up a trust in Lesotho, which receives income from a source outside Lesotho, effectively tax free. Given its tax system, it is somewhat surprising that only a limited number of trusts are indeed in use in Lesotho. One must assume that other factors, such as political stability and/or the non-resident trust taxation systems of other states (such as South Africa), play a role in the choice to avoid Lesotho.

It is thus clear that the income that is taxable in Lesotho and that flows through a trust is taxable only once. Furthermore, Lesotho follows a deduction system to achieve this aim and therefore regards that trust as a hybrid flow-through entity. Moreover, Lesotho follows a system that taxes a combination of persons. If a trust qualifies as a grantor trust or a qualified beneficiary trust, the trust is not taxed, but rather the income is taxed in the hands of the grantor or beneficiary respectively.⁶⁴ Yet, in the case of any other trust, either the trustee or the beneficiary is taxed. The residence of the grantor or the residence of the person who may ultimately benefit from the trust income may also influence the amount of chargeable income on which a trustee may be taxed.

3.3 Malawi

In general, Malawi taxes income on a source basis in terms of the Taxation Act, Chapter 41:01 (the "Taxation Act"). This Act provides that a trust is a person for purposes of the Act and that a trust will be resident in Malawi if it is established or otherwise organised under any written law of Malawi.⁶⁵ The definition of a trust includes deceased and insolvent estates, persons under legal disability as well as *usufructs*, *fideicommissa* or other limited interests.⁶⁶

⁶³ Ss 81(2) and 80. A grantor trust means a trust in relation to a whole or part of which, the grantor has (a) the power to revoke or alter the trust so as to acquire a beneficial interest in the corpus or income; or (b) a reversionary interest in either the corpus or income. A qualified beneficiary trust means (a) a trust in relation to which a person has a power solely exercisable by that person to vest the corpus or income in that person; or (b) a trust whose sole beneficiary is an individual or an individual's estate or appointees.

⁶⁴ OECD "Tax, Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Lesotho 2015 – Phase 1: Legal and Regulatory Framework" (2015) *OECD* 37.

⁶⁵ S 2 of the Taxation Act.

⁶⁶ S 2.

Yet this definition contains no reference to a trust in the narrow sense,⁶⁷ but since the definition seems to be inclusive rather than exclusive, it is submitted that a trust in the narrow sense will also qualify as a trust.

One of the provisions in the Taxation Act seems to deal with the taxation of trustees, since its heading reads “trustee”.⁶⁸ Yet, this provision only deals with income flowing through deceased estates. Hence, it cannot be applied to all trusts and furthermore, it does not deal specifically with the taxation of trusts itself. The next provision in the Taxation Act simply states that tax shall be payable by a trust for each year of assessment at the rate specified in the relevant schedule.⁶⁹ According to Munyandi, these provisions, read together, mean that “[t]rusts are treated as transparent entities for tax purposes. The ascertained beneficiaries of the trust are liable to tax for each year of assessment at the rates specified in [the relevant schedule]”.⁷⁰

If Muyaandi’s reading of the Act is accepted, it may be inferred that Malawi adheres to the policy objective of taxing income accruing to the trust only once. Furthermore, Malawi may then be classified as a state which follows the initial choice system and hence regards the trust as a hybrid flow-through entity. It does not seem possible to classify Malawi’s system in terms of the residence of the person being taxed, as Malawi generally taxes on a source basis.

3 4 Mauritius

Trusts are formed in Mauritius in terms of the Trusts Act of 2001 (the “Trusts Act”). A trust must be created in Mauritius by a written instrument.⁷¹ However, Mauritius also recognises trusts not governed by Mauritian law. Mauritian residents may be trustees of such trusts.⁷²

The Income Tax Act of 1995 (the “Mauritian ITA”) charges income tax in Mauritius. Generally, a residence basis of taxation is followed. However, non-residents are taxed on income from a Mauritian source.⁷³ The definition of a person in the Income Tax Act includes a trust. The latter is defined as

⁶⁷ Cameron et al *Honorés South African law of trusts* 4. A distinction may be drawn between trusts in the wide sense and trusts in the strict or narrow sense. A trust in the wide sense exists “whenever someone is bound to hold or administer property on behalf of another or for some impersonal object and not for his or her own benefit”. Curators of persons suffering from intellectual incapacity and agents are examples of trusts in the wide sense. By contrast, a trust in the narrow sense exists “when the creator or founder of the trust has handed over or is bound to hand over to another the control of property which, or the proceeds of which, is to be administered or disposed of by the other (the trustee or administrator) for the benefit of some person other than the trustee as beneficiary, or for some impersonal object.”

⁶⁸ S 75 of the Taxation Act.

⁶⁹ S 76.

⁷⁰ K Muyaandi “Malawi – Individual Taxation” (undated) *IBFD* para 1.1 <https://online-ibfd-org.ez.sun.ac.za/collections/gthb/html/gthb_mw_s_001.html#gthb_mw_auth> (accessed 05-06-2017).

⁷¹ OECD Global Forum on Transparency and Exchange of information for Tax Purposes Peer Review Report Combined: Phase 1 + Phase 2, incorporating Phase 2 ratings Mauritius (2013), *OECD* para 99 <http://www.oecd-ilibrary.org.ez.sun.ac.za/taxation/global-forum-on-transparency-and-exchange-of-information-for-tax-purposes-peer-reviews-mauritius-2013_9789264205826-en> accessed 27-11-2017.

⁷² OECD, Global Forum on Transparency and Exchange of information for Tax Purposes Peer Review Report Combined: Phase 1 + Phase 2, incorporating Phase 2 ratings Mauritius (2013), *OECD*, par 100

⁷³ S 5 of the Mauritian ITA.

any trust recognised under the laws of Mauritius.⁷⁴ Yet, the definition of company includes a trust.⁷⁵ Thus, a trust is, generally speaking, taxed in the same way as a company,⁷⁶ which means that a trust is liable to income tax on its chargeable income at a rate of 15%.⁷⁷ The Mauritian ITA further provides that any distribution to a beneficiary of a trust shall be deemed to be a dividend to the beneficiary.⁷⁸ However, dividends are exempt in the hands of the beneficiary.⁷⁹ Mauritius does not charge a dividends tax.

A trust will be regarded as a resident of Mauritius if it is administered in Mauritius and a majority of the trustees are resident in Mauritius; or the settlor of the trust was resident in Mauritius at the time the instrument creating the trust was executed.⁸⁰ Therefore, a trust resident in Mauritius will be liable to tax on its worldwide income, while a non-resident trust will be liable to tax only on its income from a Mauritian source.

However, Mauritius has a special regime for trusts of which the settlor is a non-resident or holds a Category 1 or a Category 2 Global Business Licence⁸¹ or another trust which qualifies for this special regime. In order to qualify, all the beneficiaries appointed under the terms of the trust must, throughout an income year, be non-residents or hold a Category 1 or a Category 2 Global Business Licence, or the trust must be a purpose trust⁸² and its purpose is carried out outside Mauritius.⁸³ If a trust qualifies for this special regime, it may declare that it is a non-resident for the particular year and will then be exempt from income tax.⁸⁴ If it does not declare itself to be a non-resident, it will be liable to tax at a rate of 15%, but will qualify for a credit in respect of foreign taxes, subject to certain limitations.⁸⁵ However, if the trust does not present written evidence showing the amount of foreign tax charged, the amount of foreign tax will be presumed to be equal to 80% of the Mauritius tax chargeable in respect of that income.⁸⁶ Hence, such a trust's tax rate will effectively be equal to 3%.

It may be concluded that the policy in Mauritius is to tax trust income only once. Regarding the method used to achieve this aim, it is not easy to classify the Mauritian system with regard to the mechanism used, since it is the trust and not the beneficiary that is taxed in Mauritius. Mauritius clearly views the trust as an entity but allows no credit for the beneficiary for taxes paid by the trust. However, the classification based on the person taxed can be applied to Mauritius, since the residence of the trust determines its

⁷⁴ S 2.

⁷⁵ S 2.

⁷⁶ OECD, Global Forum on Transparency and Exchange of information for Tax Purposes Peer Review Report Combined: Phase 1 + Phase 2, incorporating Phase 2 ratings Mauritius (2013) *OECD* para 104.

⁷⁷ Ss 44 and 46(1) read with the first schedule of the Mauritian ITA.

⁷⁸ S 46(4).

⁷⁹ S 7(2) read with the Second Schedule, Part II, Sub-part B, para 1.

⁸⁰ S 73(1)(d).

⁸¹ Under the Financial Services Act of 2007.

⁸² Under the Trusts Act of 2001.

⁸³ S 46(2) of the Mauritian ITA.

⁸⁴ S 46(3).

⁸⁵ S3 of The Income Tax (Foreign Tax Credit) Regulations GN 80 of 1996.

⁸⁶ S 8(3).

taxation. Furthermore, Mauritius's special regime for trusts is also based on the residence of the trust, since it can declare that it is a non-resident for the particular year, provided that it meets the requirements. The requirements are, however, based on the residence of the beneficiaries and the settlor.

3.5 Namibia

As is the case with Botswana, the legal history of Namibia must be considered in order to comprehend the existence and taxation of trusts in Namibia. Shortly after the First World War, South West Africa, as Namibia was then known, became a mandate of South Africa. Thus, Roman Dutch law, as it existed at that time in the Cape Province, was made applicable in Namibia (The Administration of Justice Proclamation 21 of 1919). Furthermore, the decisions of the Supreme Court of South Africa and the Roman-Dutch law that were developed by the South African courts became binding in Namibia.⁸⁷ Upon independence, Namibia adopted a constitution, which provides that the customary law and the common law of Namibia in force on the date of independence shall remain valid to the extent to which they do not conflict with the constitution or any other statutory law.⁸⁸ Furthermore, the Constitution of the Republic of Namibia, 1990 (the "Namibian Constitution") provides that all laws which were in force immediately before the date of independence shall remain in force until repealed or amended by an Act of Parliament or until they are declared unconstitutional.⁸⁹ Consequently, South African trust law, as developed by the courts in South Africa, was applicable in Namibia and remained applicable after independence.

In Namibia, the Income Tax Act 24 of 1981 (the "Namibian ITA") imposes tax on taxable income of any person.⁹⁰ In general, taxable income includes only income from a Namibian or deemed Namibian source.⁹¹ A trust is a person for income tax purposes⁹² and it is therefore the trust itself that is a taxable entity. The Namibian ITA does not contain a specific section dealing with a person's residence for general purposes. Therefore, save for provisions defining a resident for purposes of specific sections,⁹³ the Namibian ITA does not determine when a trust will be resident in Namibia and it is submitted that a trust's residence will be determined by the common law.⁹⁴ The Namibian ITA does not contain a specific section on the taxation of trusts. Prior to the introduction of section 25B into the South African Income Tax Act 58 of 1962 (the "South African ITA"), the latter act also did not contain a section specifically dealing with the taxation of trusts. Hence, the South African

⁸⁷ SK Amoo "The constitutional jurisprudential development in Namibia since 1985" in N Horn & A Bösl (eds) *Human rights and the rule of law in Namibia* (2010) 39-40.

⁸⁸ S 66(1) of the Namibian Constitution.

⁸⁹ S 140(1).

⁹⁰ S 5(1)(a) of the Namibian ITA.

⁹¹ S 1. Definition of gross income.

⁹² S 1. Definition of person.

⁹³ Ss 35A and 95A.

⁹⁴ The author was unable to find any court cases dealing with the residence of a person other than an individual. Investigating how the residence of a trust will be determined in terms of the common law falls outside the scope of this article.

position prior to the introduction of that section, which forms part of common law that is binding in Namibia, will govern the position. Thus, the trust will be regarded as a mere conduit through which income flows to the beneficiaries who have vested rights in the trust income and shall be taxed in the hands of these beneficiaries.⁹⁵ In the case where no beneficiary has a vested right in the trust income, it is submitted that it is the trust itself that will be liable to tax on the income.⁹⁶ Thus, in the case of a discretionary trust where trustees decide to distribute the trust income for the relevant tax year, the beneficiaries will be liable to tax on the relevant income.⁹⁷

Namibia therefore applies the initial choice system in the taxation of trusts to ensure that trust income is taxed only once. Trusts may therefore be classified as flow-through entities. If certain anti-avoidance provisions apply⁹⁸ and income is attributed to the settlor, Namibia's system may possibly be classified as attributing income based on the residence of the settlor. However, bearing in mind that Namibia taxes on a source basis, the residence of the settlor is not really relevant. For the same reason, the residence of the trust and beneficiaries is irrelevant, even though income may be taxed in either the hands of the trust or the beneficiaries. It therefore does not seem to be possible to classify the Namibian system under the second type of classification criteria.

3 6 Seychelles

Seychelles law does not know domestic trusts. However, international trusts may be created in terms of the International Trusts Act 26 of 1994 (the "Seychelles ITA") in the Seychelles.⁹⁹ The requirements for such a trust include that the settlor should not at any time during the existence of the trust be a resident of the Seychelles, at least one trustee must be resident in the Seychelles and none of the trust property must be situated in the Seychelles.¹⁰⁰ These trusts are exempt from tax in the Seychelles.¹⁰¹ Save for possibly classifying these trusts as a separate entity, the tax system cannot be classified under any of the other systems discussed in the introduction.

⁹⁵ *Armstrong v Commissioner for Inland Revenue* 1938 AD 343 10 SATC 1.

⁹⁶ In South Africa, prior to the introduction of section 25B into the South African ITA and the amendment to the definition of "person" in section 1, the practice of the revenue authority was to tax the trustees of the trust as representative taxpayers in a case where there was no beneficiary with a vested right to the income. *Commissioner for Inland Revenue v Friedman and Others* NNO 1 SA 353 (A) successfully challenged this practice, resulting in an amendment of the Income Tax Act, *inter alia*, to include a trust in the definition of a person. As stated above, in Namibia, the definition of a person includes a trust. Thus, it is the trust that will be liable to tax in the absence of a beneficiary with a vested right.

⁹⁷ *Secretary for Inland Revenue v Rosen* 1971 1 SA 172 (A). It is further submitted that the income will retain its nature in the hands of the beneficiary.

⁹⁸ For example, section 12(3) of the Namibian ITA, which taxes income received or accrued or accumulated for the benefit of a minor child in the hands of the parent, if it was received or accrued by reason of a donation settlement or other disposition by the parent.

⁹⁹ OECD *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Seychelles 2013: Phase 2: Implementation of the Standard in Practice* (2013) OECD para 136 <http://www.oecd-ilibrary.org/ez.sun.ac.za/taxation/global-forum-on-transparency-and-exchange-of-information-for-tax-purposes-peer-reviews-seychelles-2013_9789264206199-en> (accessed on 27-11-2017).

¹⁰⁰ OECD *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Seychelles 2013: Phase 2: Implementation of the Standard in Practice* (2013) OECD para 136.

¹⁰¹ OECD *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Reviews: Seychelles 2013: Phase 2: Implementation of the Standard in Practice* (2013) OECD paras 141 and 205.

3.7 South Africa

In South Africa, the South African ITA, which imposes income tax, defines a trust.¹⁰² Once an entity is brought within the ambit of the definition of a trust, it will be regarded as a person¹⁰³ for purposes of the Act and will, consequently, be liable to tax in terms of that Act.¹⁰⁴ In general, South Africa follows a residence basis of taxation. Therefore, trusts that are resident in South Africa are taxed, generally speaking, on their worldwide receipts and accruals, while trusts that are non-residents are taxed, generally speaking, only on income from South African sources.¹⁰⁵ Trusts are regarded as resident in South Africa if they are established or formed in South Africa, or if they have their place of effective management in South Africa. However, a trust will not be regarded as a South African resident if it is deemed to be exclusively a resident of another state in terms of a double taxation treaty.¹⁰⁶

The South African ITA provides that an amount that is received by or accrues to a trust, is deemed to have accrued to a beneficiary, if that beneficiary is ascertained, has a vested right to the income and the amount has been derived for the benefit of that beneficiary. In such a case, the beneficiary is liable to tax on the relevant amount and the trust is not taxed on that amount at all. However, an amount that is received by or accrues to a trust is taxed in the hands of the trust if there is no ascertained beneficiary, for whose benefit the amount was derived, with a vested right to that income. In such a case, only the trust will be taxed and not the beneficiary.¹⁰⁷

In the case of a discretionary trust, the exercise by the trustee of his or her discretion in favour of the beneficiary will result in the beneficiary acquiring a vested right to an amount received by or accrued to a trustee during that year of assessment.¹⁰⁸ Therefore, if the trustee of a discretionary trust exercises his or her discretion in favour of a beneficiary during a particular year of assessment, the beneficiary will be regarded as having a vested right to the relevant income and will, consequently, be taxed on that income. The trust will, therefore, not be liable to tax in respect of the income distributed to such a beneficiary.

In an international context, a further provision of section 25B should be borne in mind. It deals with distributions from non-resident trusts and aims to combat the accumulation of income in a trust (which is not from a South African source and therefore not taxed in South Africa) and the subsequent distribution thereof as capital, thus avoiding the payment of income tax in South Africa.¹⁰⁹ It provides that if any resident acquires any vested right in the year of assessment to any amount representing capital of any non-resident

¹⁰² S 1 of the South African ITA.

¹⁰³ S 1. Definition of person.

¹⁰⁴ S 5(1)(c).

¹⁰⁵ S 1. Definition of gross income.

¹⁰⁶ S 1. Definition of resident.

¹⁰⁷ S 25B(1).

¹⁰⁸ S 25B(2).

¹⁰⁹ RD Jooste "Offshore Trusts and Foreign Income – the Specific Anti-avoidance Provisions" (2002) *Acta Juridica* 201; D Davis, C Beneke & RD Jooste *Estate Planning* (2013) para 6.3.1.

trust, that amount must be included in the income of that resident in that year, if (a) that capital arose from any receipts and accruals of such trust which would have constituted income if such trust had been a resident, in any previous year of assessment during which that resident had a contingent right to that amount; and (b) that amount has not been subject to tax in South Africa in terms of the South African ITA.¹¹⁰

It may be concluded that South Africa follows the initial choice system in general and that it views the trust as a hybrid flow-through entity. Under the other classification method, it uses a combination of systems. Thus, in South Africa, some anti-avoidance provisions¹¹¹ will ensure that certain income is taxed in the hands of the settlor. The trust is regarded as a person and taxed in South Africa on all undistributed income if it is resident there and the beneficiaries of a trust are taxed if they have a vested right to the income.

3.8 Swaziland

Income tax is charged in Swaziland in terms of the Income Tax Order King's Order in Council No 21 of 1975 (the "Income Tax Order"). Generally, only income from a source in Swaziland is taxed.¹¹² Trusts are regarded as persons in Swaziland.¹¹³ Although the term trust is not defined in the Income Tax Order, the term trustee is defined to include, in addition to every person appointed or constituted as such by act of parties, by will, by order or declaration of Court or by operation of law, an executor or administrator, tutor or curator, and any person having the administration or control of any property subject to a trust, usufruct, *fideicommissum* or other limited interest, or acting in any fiduciary capacity, or having, either in a private or an official capacity, the possession, direction, control or management of any property of any person under legal disability. The Income Tax Order does not provide when a trust will be regarded as a resident of or ordinarily resident in Swaziland.¹¹⁴

The Income Tax Order further provides that any income received by or accrued to, or in favour of any person during the year of assessment in his capacity as a trustee of a trust, shall to the extent that such income has been derived for the immediate or future benefit of any ascertained beneficiary with a vested right to such income, be included in the gross income of the beneficiary.¹¹⁵ Where a beneficiary has acquired such a vested right as a result of the exercise by the trustee of a discretion vested in the trustee, such income

¹¹⁰ S 25B(2A) of the South African ITA.

¹¹¹ S 7. South Africa recently introduced section 7C, a provision that, generally speaking, deems the difference between interest that was charged and interest at official rate of interest, on loans by a connected person to a trust, to be a donation that is subject to donations tax. The Davis Tax Committee have proposed a number of additional amendments in respect of the taxation of trusts, many of which have not found their way into legislation at the date of drafting this article. A discussion of these proposals, or any possible future amendments to the taxation of trusts in South Africa, fall outside the scope of this article.

¹¹² S 6(1), read with s 7 of the Income Tax Order.

¹¹³ S 1. Definition of person.

¹¹⁴ Section 59 does define the term "non-resident person" to mean "any person whose principal place of business is outside Swaziland", but only for limited purposes, such as section 59 itself, section 59A and section 59C. Determining when a trust will be resident in Swaziland falls outside the scope of this article.

¹¹⁵ S 19bis (1) of the Income Tax Order.

is deemed to have been derived for the benefit of a beneficiary.¹¹⁶ Furthermore, the beneficiary is allowed a deduction for any expenditure or losses incurred by the trustee in deriving the income included in the beneficiary's gross income.¹¹⁷ A feature that is unique to Swaziland is that trustees are obliged to withhold tax at the rate of 33% of the gross amount of any payment from trust income to a beneficiary with a vested right to such income.¹¹⁸ The tax so withheld is on account of the liability to tax of the beneficiary on the income derived from the trust.¹¹⁹ It does not seem to be a final tax, as the beneficiary is not relieved from the obligation to lodge a return.¹²⁰

The trust's taxable income is so much of the income of the trust as is not included in the gross income of a beneficiary or exempted, less all allowable deductions.¹²¹ However, the trustee is liable for tax on the trust's taxable income.¹²² The trustees are also jointly and severally liable for such tax.¹²³

However, the rule that income that is received or accrued in favour of a beneficiary with a vested right is included in the gross income of the beneficiary, does not apply in the following three cases, namely (a) income which has been subject to withholding tax¹²⁴ on payment into the trust and, if it had been received by or accrued directly to the beneficiary, the withholding tax would be a final tax; (b) an incapacitated person's trust, in which case the trustee is liable for the taxable income of the trust; and (c) a beneficiary who is above sixty years of age.¹²⁵

Although the system in Swaziland has a few unique features not otherwise found in the states under review, it follows the same basic policy principle that income passing through the trust should only be taxed once. Furthermore, it follows the initial choice system, since it is determined immediately whether the trustee or the beneficiary will be liable to tax. Trusts are therefore taxed as hybrid flow-through entities. Even though it has a withholding tax on income paid by the trust to the beneficiary, it is submitted that the withholding tax is simply a collection mechanism, since it is not a final tax.

If certain deeming provisions apply, trust income is attributed to the settlor. It may possibly be argued that Swaziland's system for the taxation of trusts may be classified as attributing income based on the residence of the settlor. However, bearing in mind that Swaziland taxes on a source basis, the residence of the settlor, the trust and beneficiaries is irrelevant, even though income may be taxed in the hands of any of them. It therefore does not seem

¹¹⁶ S 19bis (3).

¹¹⁷ S 19bis (4).

¹¹⁸ S 32G(1).

¹¹⁹ S 32G(2).

¹²⁰ S 32G(5).

¹²¹ S 19bis (6).

¹²² S 19bis (5).

¹²³ S 19bis (7).

¹²⁴ Swaziland charges a non-resident shareholder tax, a non-residents tax on interest, non-residents' tax on entertainment and sports, a withholding Tax on Payments to Non Resident Contractors; withholding Tax on Repatriated Income and a tax on royalties and management charge paid to non-residents. Furthermore, a withholding tax is applied in respect of interest and dividends paid to residents, rental payments and payments to beneficiaries of trusts.

¹²⁵ S 19bis(2) of the Income Tax Order.

to be possible to classify the Swaziland system under the second type of classification criteria.

3.9 Tanzania

Income tax is imposed, generally, on a residence basis in terms of the Income Tax Act of 2004, Chapter 332 (the “Tanzanian ITA”).¹²⁶ A trust is defined as “an arrangement under which a trustee holds assets” and excludes a partnership and a corporation.¹²⁷ Hence, the definition of trustee must be examined. This definition includes, *inter alia*:

“[A]n individual or body corporate holding assets in a fiduciary capacity for the benefit of identifiable persons or for some object permitted by law and whether or not the assets are held alone or jointly with other persons or the individual or body corporate is appointed or constituted trustee by personal acts, by will, by order or declaration of a court or by other operation of the law.”

A trust is regarded as an entity and therefore also as person for purposes of the Tanzanian ITA.¹²⁸

The Act makes plain that a trust is liable to tax separately from its beneficiaries.¹²⁹ Thus, income received by the trust will be taxed in the hands of the trust itself. In fact, the legislation specifically states that amounts derived and expenditure incurred by a trust or a trustee in the capacity of trustee (other than as a bare agent), must be treated as derived or incurred by the trust and not any other person, irrespective of whether derived or incurred on behalf of another person or whether any other person is entitled to such an amount or income comprising of such an amount.¹³⁰

If a resident trust makes distributions, these will be exempt in the hands of the beneficiary. However, if it is a non-resident trust making a distribution, the distribution is included in the beneficiary’s income.¹³¹ A trust is a resident for a year of income if (a) it was established in Tanzania; (b) a trustee of the trust is a resident person at any time during the year of income; or (c) at any time during the year of income a resident person directs or may direct senior managerial decisions of the trust, whether the direction is or may be made alone or jointly with other persons or directly or through one or more interposed entities.¹³²

Thus, it seems that in the case of a non-resident trust receiving income from a Tanzanian source, the income flowing through the trust is taxed twice, first in the hands of the trust and second when it is distributed to the beneficiary. However, in the case of a resident trust, the income is taxed only once, namely when it is derived by the trust. Thus, the residence of the trust is crucial to the manner in which the beneficiary will be taxed. In determining the residence of the trust (and thus the taxation of the beneficiary), one of the facts that will

¹²⁶ Ss 5 and 6 of the Tanzanian ITA.

¹²⁷ S 3.

¹²⁸ S 3. Definition of entity and person.

¹²⁹ S 52(1).

¹³⁰ S 52(3).

¹³¹ S 52(2).

¹³² S 66(3).

determine residency is the residence of the trustees. Thus, the residence of the trustees may influence the way in which the beneficiaries will be taxed. The residence of the beneficiary will, however, be irrelevant.

It should further be noted that in Tanzania a trust might fall within the controlled foreign company regime. Such a trust is treated as distributing to its members at that time its unallocated income for the year of income.¹³³

3 10 Zambia

Generally speaking, Zambia charges income tax on a source basis. However, all persons ordinarily resident in Zambia are liable to income tax in respect of interest and dividends from a source outside of Zambia.¹³⁴ Trusts are regarded as “persons” for income tax purposes in Zambia.¹³⁵ Furthermore, trusts are regarded as residents of Zambia for a particular year if they are incorporated or formed under the laws of Zambia; or if the central management and control of the trust’s business or affairs are exercised in Zambia for that year.¹³⁶

The Income Tax Act 3 of 1997, Chapter 323 (the “Zambian ITA”) provides that the Commissioner-General may determine to assess and charge income of a trust attributable to the beneficiary’s interest for any charge year or any amount paid out of the income of the trust on behalf of the beneficiary in any charge year, on the beneficiary as if it were his income. In the alternative, the Commissioner-General may assess and charge the whole or part of the income on the trustees.¹³⁷ A beneficiary is deemed to receive the gross amount of income from the trust before the deduction of taxes, if the trust paid taxes on the amount.¹³⁸ The Zambian ITA further provides that where a beneficiary entitled to the whole or part of the income of a trust, is assessed and chargeable to tax for any charge year in respect of that income, any tax paid by a trust and attributable to the income so assessed and charged on the beneficiary, shall be set off against the tax chargeable for that charge year on the beneficiary. The beneficiary shall be entitled to a refund of any amount paid in excess of the tax chargeable.¹³⁹

The Zambian ITA also contains a far-reaching anti-avoidance provision in relation to trusts. It provides that where, because of the existence of a trust, the incidence of tax for any charge year in relation to a person beneficially interested in that trust is less than would be the case if that trust (apart from the ascertainment of the nature and amount of the beneficiary’s interest for the purposes of the relevant subsection) did not exist, the Commissioner-General may determine that the income of the trust attributable to that beneficiary’s

¹³³ See ss 73-76. A further discussion of this regime falls outside the scope of this article.

¹³⁴ S 14(1) of the Zambian ITA.

¹³⁵ S 2. Definition of person.

¹³⁶ S 4(3).

¹³⁷ S 27(4).

¹³⁸ S 60(3).

¹³⁹ S 89. A further refund is available to a beneficiary in terms of section 88, where income is accumulated in a trust until the beneficiary attains a certain age or marries. If the total amount paid by the trust until the event occurs exceeds the tax that the beneficiary would have been paid by the beneficiary during the same period if the trust income had been included in the beneficiary’s income, the beneficiary may claim a refund for the difference.

interest for any charge year shall for the purposes of the Act be assessed as if it were his income, and it shall be assessed and charged accordingly.¹⁴⁰

A further anti-avoidance provision¹⁴¹ contained in the *Zambian ITA* refers, *inter alia*, to cases where a settlement (which includes a trust) is, in the opinion of the Commissioner-General, not made for valuable and adequate consideration. If, in such cases, during the life of the settlor any income, or assets representing it, will or may become payable or applicable to or for the benefit of any child of the settlor and at the commencement of the charge year the child is unmarried and has not attained the age of twenty-one years, the income or assets representing it shall be deemed to be income of the settlor and not income of any other person. A similar attribution provision applies when the settlement is revocable and the settlor or his spouse will or may become beneficially entitled to the whole or any part of the property or income of the settlement. Attribution to the settlor will also occur if the settlor or any relative of the settlor or any person under the direct or indirect control of the settlor or of any of his relatives, whether by borrowing or otherwise, makes use of any income arising or of any accumulated income under a settlement to which he is not entitled thereunder. In all of these cases, the settlor may recover from any trustee or other person to whom income is paid under the settlement the amount of the tax paid by the settlor.

In summary and leaving aside cases in which valuable and adequate consideration were not given, the Commissioner-General may, in circumstances where income is attributable to the beneficiary's interest or an amount is paid out of the trust income on behalf of the beneficiary, choose whether to assess the trust or the beneficiary. It seems that in other circumstances the trust will be taxed on income. However, if the trust is taxed, but the tax is less than it would have been, had the trust not existed, the beneficiary will be taxed in terms of the anti-avoidance provision. If the beneficiary is taxed, he or she may set off the tax paid by the trust against that tax charged on the beneficiary and may claim a refund, if applicable. Thus, it may be concluded that the *Zambian* system uses elements of the initial choice system, because the Commissioner-General may choose whether to assess the trust or the beneficiary. However, the *Zambian* system also reminds one of the credit system, since the beneficiary of a *Zambian* trust is entitled to set off the tax paid by the trust against the tax charged on the beneficiary in respect of the trust income. It does not seem possible to classify the *Zambian* system in respect of the mechanism used. It is furthermore difficult to determine whether the trust is viewed as a separate entity or a hybrid flow-through entity, since its system displays elements of both approaches.

¹⁴⁰ S 97(1) of the *Zambian ITA*.

¹⁴¹ S 19.

3 11 Zimbabwe

Tax is generally charged on a source basis in Zimbabwe.¹⁴² The Income Tax Act, Chapter 23:06 (the “Zimbabwean ITA”) does not contain a general provision setting out when a trust will be regarded as a resident of Zimbabwe. In Zimbabwe, a trust will be regarded as a person, but only in respect of income, the subject of a trust to which no beneficiary is entitled.¹⁴³ Income the subject of a trust to which no beneficiary is entitled, means

“income the subject of a trust created by a trust instrument which—

- (a) is not paid to or applied to the benefit of—
 - (i) a beneficiary with a vested right; or
 - (ii) a person who would but for—
 - A. the conferment on the trustee by the trust instrument of a discretion so to pay or apply the income; and
 - B. the happening of some event stipulated in the trust instrument other than the exercise of that discretion;
 be a beneficiary with a vested right;
 - or
- (b) is not income deemed by virtue of section *ten* to have been received or have accrued to or in favour of the person by whom the trust instrument was made; or
- (c) is not accumulated in terms of the trust instrument for the future benefit of a beneficiary with a vested right.”

A beneficiary with a vested right, in relation to income the subject of a trust created by a trust instrument, is defined as “a person named or identified in the trust instrument who has at the time the income is derived an immediate certain right to the present or future enjoyment of the income”.¹⁴⁴

Thus, if a beneficiary has a vested right, but income is not paid to or applied for the benefit of that beneficiary, but rather retained in the trust, the trust will be regarded as a person and therefore liable to tax in respect of that income.¹⁴⁵ Otherwise, the beneficiary will be liable for tax on the income. In other words, if income is paid to a beneficiary with a vested right, the beneficiary will be taxed on the income. However, income that is not accumulated for the future benefit of a beneficiary with a vested right will be income to which no beneficiary is entitled, and which will thus be taxed in the trust. If income is distributed to a discretionary beneficiary, the beneficiary is taxed on the income.¹⁴⁶

However, in respect of non-resident shareholder’s tax,¹⁴⁷ resident shareholders’ tax¹⁴⁸ and residents’ tax on interest¹⁴⁹ a trust is regarded as a person in relation to income the subject of a trust to which a beneficiary is entitled.¹⁵⁰

¹⁴² S 8(1) of the Zambian ITA. Definition of gross income.

¹⁴³ Zimbabwe Revenue Authority “Taxation of Trusts” (2014) *ZIMRA* <http://www.zimra.co.zw/index.php?option=com_content&view=article&id=2230:taxation-of-trusts&catid=21:did-you-know&Itemid=91> (accessed 08-09-2017).

¹⁴⁴ S 2 of the Zimbabwean ITA.

¹⁴⁵ S 6.

¹⁴⁶ Zimbabwe Revenue Authority “Taxation of Trusts” (2014) *ZIMRA*.

¹⁴⁷ S 9th Schedule para 1 of the Zimbabwean ITA.

¹⁴⁸ S 15th Schedule para 1.

¹⁴⁹ S 21st Schedule para 1.

¹⁵⁰ A detailed discussion of these taxes falls outside the scope of this article.

It can be deduced that in Zimbabwe the policy of taxing the income passing through a trust only once is followed. Furthermore, it is clear that the Zimbabwean legislation follows an initial choice system and thereby treats the trust as a hybrid flow-through entity. It may not be possible to classify the Zimbabwean system based on the person being taxed, since Zimbabwe follows a source-based system generally.

4 Policy and systems for the taxation of trusts in the relevant SADC member states

The first question that this article set out to answer was whether the SADC member states follow the same broad policy aim as their common-law counterparts in the taxation of trusts, namely that income passing through the trust is taxed only once. This question may, generally speaking, be answered in the affirmative.¹⁵¹

The second question was whether it is possible to classify the systems used by the applicable SADC member states in the taxation of trusts, into the classification system identified by academics in respect of certain common-law states. This question may, in general, also be answered in the positive, although it is difficult to classify certain states in terms of the classification systems, as will be discussed below.

In the analysis regarding the classification focussing on the mechanism used, it appears that Malawi, Namibia, South Africa, Swaziland and Zimbabwe use the initial choice system. To a certain extent, Zambia also uses the initial choice system, but as explained above, Zambia also exhibits elements of the credit system. Only Lesotho uses the deduction system. It was not possible to classify the systems used in Botswana, Mauritius and Tanzania in accordance with the mechanism used, since these states only tax the trust and not the beneficiaries. The following table illustrates how the SADC member states can be classified in accordance with the mechanism used:

System	Countries
Credit	Zambia
Initial choice	Malawi, Namibia, South Africa, Swazi-land, Zambia, Zimbabwe
Deduction	Lesotho
Unable to classify	Botswana, Mauritius, Tanzania

Concerning the classification system that focusses on the person being taxed, Mauritius, Tanzania and South Africa base the taxation of trusts on the residence of the trust or the trustee. However, South Africa also taxes amounts in the hands of a resident, which would typically be the settlor, if certain anti-avoidance provisions, for example, section 7(8), apply. Many other states also have anti-avoidance provisions which may attribute trust income to a resident settlor, a point reverted to later. The residence of the beneficiary is relevant

¹⁵¹ Tanzania may be an exception to this general statement, but only in respect of non-resident trusts receiving Tanzanian source income.

for the imposition of taxation in Lesotho and South Africa. However, the majority of states (that is, Botswana, Malawi, Namibia, Swaziland, Zambia and Zimbabwe) could not be classified using a system based on the person being taxed. It is submitted that the main reason why such classification was not possible, is because these states tax on the basis of source. The residence of a specific person is therefore not a relevant criterion for the imposition of taxation. It is therefore submitted that this classification system is not suitable to classify the systems used by the relevant SADC member states. The following table sets out how the SADC member states can be classified in accordance with the person taxed, insofar as this is possible:

System	Countries
Resident settlor	South Africa
Resident trust/trustee	Mauritius, Tanzania, South Africa
Resident beneficiary	Lesotho, South Africa

Referring to the classification distinguishing between a hybrid flow-through and a separate entity, the discussion above reveals that Botswana, Mauritius and Tanzania follow a separate entity approach, while Lesotho, Malawi, Namibia, South Africa, Swaziland and Zimbabwe follow a hybrid flow-through approach. It is difficult to classify the Zambian system as falling within either of these two categories, since it exhibits elements of both. The following table sets out which SADC member states tax trusts as separate entities and which states use the hybrid flow-through system.

System	Countries
Separate entity	Botswana, Mauritius and Tanzania
Hybrid flow-through	Lesotho, Malawi, Namibia, South Africa, Swaziland and Zimbabwe

As predicted by academics, many states use a combination of the systems described above. South Africa serves as a useful example: in South Africa, some anti-avoidance provisions will ensure that certain income is taxed in the hands of a resident settlor, thus placing it in a system based on the residence of the settlor. Nevertheless, the trust is regarded as a person and taxed in South Africa if it is resident there on all undistributed income and the beneficiaries of a trust are taxed if they have a vested right to the income, thus putting South Africa into a system which taxes based on the residence of both the trust and the beneficiary. Furthermore, South Africa may also be classified as following an initial choice system and treating the trust as a hybrid flow-through entity.

Of note is the degree of similarity, not only in the policy aim adopted by the relevant SADC member states of taxing income flowing through the trust only once, but also between the systems generally used by them. Thus, the majority of states use the initial choice system and therefore classify the trust as a hybrid flow-through entity. The second largest group of states taxes only the trust and therefore views the trust as a separate entity. Selecting one group’s approach above the other is difficult, since both have their advantages and disadvantages as highlighted above. However, if it is borne in mind that the SADC member states using the separate entity system do not allow for a

refundable credit in the hands of the beneficiary for taxes paid by the trust, it is submitted that the initial choice system should be preferred. Without the refundable credit, the separate entity system, although simple, is unfair to low-income beneficiaries, a problem not encountered in the initial choice system.

5 Trends in the taxation of trusts in the SADC member states

A number of interesting trends may be noted when the tax treatment of trusts in the various states are compared. First, all the states discussed here, except Lesotho, include a trust (or the trustee) in the definition of a person in the domestic legislation of the particular state. In Lesotho, neither the trust nor the trustee is included in the definition of a person. However, in Botswana, it is the trustee that is included in the definition of a person and in Zimbabwe, the trust is a person only in respect of income to which no beneficiary is entitled.

Second, the majority of states’ domestic legislation contains a provision that determines when a trust will be regarded as a resident in that state. Thus, the legislation in Botswana, Malawi, Mauritius, South Africa, Tanzania and Zambia includes rules to establish a trust’s residence. Conversely, no such rules exist in Lesotho, Namibia, Swaziland and Zimbabwe.

Third, the criteria used by the relevant SADC member states to determine residence of a trust may be distilled. The criterion of establishment is used in Botswana, Malawi, South Africa, Tanzania and Zambia. Therefore, all the states that have rules to establish residence use this criterion, except Mauritius. The use of the managed and controlled criterion (or similar concepts) is also widespread, it being used in Botswana, South Africa, Tanzania and Zambia to determine the residence of a trust. Only Mauritius and Tanzania rely on the residence of the trustee, whereas Mauritius is the only state that uses the residence of the settlor on creation of the trust as criterion. Interestingly, most states under discussion use a number of alternative criteria to determine a trust’s residence.¹⁵² The following table shows the criteria used by the relevant states to determine the residence of a trust.

Criterion	State
Establishment	Botswana, Malawi, South Africa, Tanzania, Zambia
Management and control	Botswana, South Africa, Tanzania, Zambia
Residence of trustee	Mauritius, Tanzania
Residence of settlor on creation	Mauritius

Fourth, many of the relevant SADC member states have included some form of anti-avoidance mechanism in their legislation. For example, in Botswana, Lesotho, Namibia, South Africa, Swaziland, Zambia and Zimbabwe, trust income is attributed to another person under certain circumstances.

¹⁵² The influence of double taxation treaties on the residence of a trust falls outside the scope of this article.

6 Conclusion

Generally speaking, the SADC member states discussed in this article subscribe to the policy aim of taxing income flowing through the trust only once. It is possible to use the classification systems based on the mechanisms used and the separate entity or hybrid flow-through entity to classify the systems used by the relevant SADC member states. However, it is submitted that the classification system based on the person that is to be taxed is not suitable to classify the systems used by the relevant SADC member states. Many of the states use a combination of the systems described in this article.

A number of similarities between the relevant states are noticeable. The majority of states use the initial choice system, regarding the trust as a hybrid flow-through entity. Furthermore, generally speaking, all states bar one regard the trust (or trustee) as a person. The majority of states also include criteria to determine whether a trust is a resident in that state in their legislation. There is also a degree of overlap in the criteria used by these states to determine residence. If harmonisation is ever pursued, these similarities may provide a foundation for the endeavour, although significant differences are also present.

It cannot be gainsaid that trusts are commonly used in international transactions. As the OECD's BEPS project shows, most states are eager to ensure that they receive their fair share of tax and tax on the income passing through the trust is no exception. Thus, states must ensure that they have effective policies and systems in place to tax such income. As this article has shown, the SADC member states discussed herein by and large use systems that can be classified in the same way as those used in common-law states. That said, the SADC member states should continuously improve their legislation to ensure that it is able to meet the challenges posed, *inter alia*, by BEPS.

SUMMARY

Many Southern African Development Community ("SADC") member states use trusts and they have proved to be very popular in some of these states. This article examines the way in which income acquired by a trust is taxed in a number of SADC member states. It determines whether the systems used by the SADC member states can be placed in the classification systems identified by academics in respect of certain common-law states. It also notes a number of trends in the taxation of trusts in the relevant states.